



THE UNIVERSITY *of* EDINBURGH

Edinburgh Research Explorer

The never-ending issue of cross-border loss compensation within the EU

Citation for published version:

Cerioni, L 2015, 'The never-ending issue of cross-border loss compensation within the EU: Reconciling balanced allocation of taxing rights and cross-border ability-to-pay', *EC Tax Review*, vol. 24, no. 5. <<https://www.kluwerlawonline.com/abstract.php?area=Journals&id=ECTA2015027>>

Link:

[Link to publication record in Edinburgh Research Explorer](#)

Document Version:

Peer reviewed version

Published In:

EC Tax Review

Publisher Rights Statement:

'This is a pre-edited work and has been accepted for publisher in EC Tax Review.'

General rights

Copyright for the publications made accessible via the Edinburgh Research Explorer is retained by the author(s) and / or other copyright owners and it is a condition of accessing these publications that users recognise and abide by the legal requirements associated with these rights.

Take down policy

The University of Edinburgh has made every reasonable effort to ensure that Edinburgh Research Explorer content complies with UK legislation. If you believe that the public display of this file breaches copyright please contact openaccess@ed.ac.uk providing details, and we will remove access to the work immediately and investigate your claim.



THE NEVER-ENDING ISSUE OF CROSS-BORDER LOSS COMPENSATION WITHIN THE EU: RECONCILING BALANCED ALLOCATION OF TAXING RIGHTS AND CROSS-BORDER ABILITY-TO-PAY

By dr. Luca Cerioni (*)

Although the case-law on cross-border loss offsetting has been developed by the ECJ, to date, only on the bases of fundamental freedoms, and has been oscillating between a global approach and a single country approach, these two approaches could be reconciled with a view to an ultimate concern to avoid tax evasion and tax avoidance within the EU territory. Moreover, this concern would be fully consistent with the development of an EU law principle of ability-to-pay, which could arguably be applied, inter alia, through a fractional deduction of cross-border losses in each Member State even for those taxpayers not falling within the CCCTB project, to the benefit of both balanced allocation of taxing rights and taxpayers' interests.

1. Introduction

With regard to the never-ending issue of cross-border compensation of losses within the EU and to the granting of personal deductions for taxpayers earning income in Member States other than the residence State, academic literature recently raised a challenging question: whether the ECJ could make a proportional application of the ability-to-pay principle, depending on the proportion of the income falling within the tax jurisdiction of each Member State¹.

This article attempts at providing a response to this question with specific regard to the offsetting of cross-border corporate losses and of cross-border losses suffered by individual taxpayers.

After highlighting the key ECJ's concerns about cross-border loss offsetting, two arguments are submitted. Firstly, two apparently contrasting approaches followed by the ECJ could be reconciled from the specific viewpoint of an ultimate anti-evasion and anti-avoidance concern to be pursued within the EU territory, which would also be compatible with the ability-to-pay principle. Secondly, this concern could be met more effectively, and the ability-to-pay principle could be applied in cross-border situations, if, instead of relying only on fundamental freedoms, the ECJ were to rely on the objective of the EU stated in Art. 3(1) of the Treaty on the Functioning of the European Union (TFEU) and on the fundamental EU principle of *equality*. It is argued that, ultimately, based on this principle, the ECJ would find no obstacle in elaborating a European principle of ability-to-pay, which would lead to a positive response to the question at stake and would manage to reconcile the interests of taxpayers and of Member States more effectively than the current case-law.

2. The ECJ's concerns and approaches on cross-border losses offsetting

(*) Lecturer in Tax Law, School of Law, University of Edinburgh (formerly, winner of the Rita Levi Montalcini research grant for the project "EU tax law between tax sovereignty of Member States and proper functioning of the internal market: a solution to reconcile different but equally necessary goals" hosted by the Università Politecnica delle Marche, Italy)

¹ F. Vanistendael, *Ability to Pay in European Community Law*, EC Tax Review 3, 2014, 121-134, at 134.

In all cases concerning cross-border losses offsetting, the plaintiffs have been alleging that national provisions were infringing fundamental freedoms, in particular the freedom of establishment under Art. 49 and 54 of the TFEU, and Member States have been justifying their provisions establishing differential treatments between domestic and cross-border situations, on the bases of specific grounds: cohesion of national tax systems; territoriality; prevention of tax avoidance; balanced allocation of taxing powers.

The principle of cohesion of a national tax system, first accepted in 1992 in *Bachmann*², was defined by the ECJ as involving three cumulative elements: a direct link between a cost deduction and the taxation of a related benefit; the application of one type of tax; its application to a single taxpayer. This principle, in essence, identifies the cohesion of a national tax system in terms of symmetry at *taxpayers' level* between costs deduction and related profit taxation. The territoriality principle was introduced by the ECJ in the 1997 *Futura* ruling³ in terms of economic matching between profits and losses arising from the business activity of a (corporate) taxpayer within the territory of a Member State⁴. In turn, a symmetric treatment of profit and losses in the same jurisdiction is also crucial for preserving the allocation of taxing powers between Member States, i.e. for denying companies the option to deduct losses in the Member State in which they are established or in another one: this is the essence of a justification which, since the 2005 landmark *Marks & Spencer* ruling⁵, has been known in terms of “balanced allocation of taxing powers”. As properly noted, the “balanced allocation of taxing power” seems to be used as a justification to avoid a “loss trafficking” (aimed at minimizing the overall tax liability), and thus it would not differ from a measure to fight the risk of tax avoidance⁶.

Having regard to the overall ECJ jurisprudence, literature has been questioning the conceptual distinction between the “cohesion of the tax systems”, the “territoriality principle” and the “balanced allocation of taxing powers”⁷. It has been convincingly arguing that these expressions all indicate the ECJ’s efforts to reconcile an internal market and the almost complete absence of EU harmonization, which legitimizes each individual Member State to protect its tax revenues against territorial mismatches of profits and corresponding losses⁸, and has noted that “Principles emerge, disappear and re-emerge in different guise”⁹. Undoubtedly, the ultimate and common goal of Member States lies in *preventing an erosion* of their own tax base, and the ECJ had to decide, from time to time, in light of justifications

² Case C-204/90 *Bachmann* [1992] ECR I-249.

³ Case C-250/95, *Futura Participations SA*, [1997] ECR I-02471

⁴ *Id.*, para. 21-22

⁵ Case C-446/03, *Marks & Spencer* [1995] ECR I- 10837, para. 43 and 45-46.

⁶ M.Wathelet, *Tax Sovereignty of Member States and the European Court of Justice: New Trends or Confirmation? A Vision of Taxes Within and Outside European Borders*; Festschrift in Honor of Prof. Dr. Frans Vanistendael, L.Hinneken & P.Hinneken (ed.), Kluwer Law International, 2008, at 92. In the same sense, R.Neyt, S.Peeters, *Balanced Allocation and Coherence: Some Thoughts in Light of Argenta and K*, EC Tax Review 2, 2014, 64-75, at 70-72.

⁷ P.Wattel, *Fiscal cohesion, fiscal territoriality and preservation of the (balanced) allocation of taxing powers; what is the difference?*, in D.Weber (ed.), *The Influence of European Law on Direct Taxation*, Kluwer Law International, 2007, 139-157. G.Turner, “Coherence of the tax systems” and “balanced allocation of taxing powers” contrasted, *International Tax Report*, Part I, 06/2013, 1-8, and Part II, 07-08/2013, 1-8. According to D.Weber, *An Analysis of the Past, Current and Future of the Coherence of the Tax System as Justification*, in EC tax review 1, 2015, 43-54, the fiscal territoriality principle can be better protected by the balanced allocation of taxing powers, and the cohesion justification can still apply usefully only if the internal national cohesion of a tax system is infringed, whereas in all other cases even this justification has become redundant and is absorbed by the balanced allocation of taxing rights.

⁸ P.Wattel, *Fiscal cohesion, fiscal territoriality and preservation of the (balanced) allocation of taxing powers; what is the difference?*, *cit.*, 153-154

⁹ S.Eden, *The Obstacles Faced by the European Court of Justice in Removing the “Obstacles” Faced by the Taxpayer: the Difficult Case of Double Taxation*, in *British Tax Review* 6, 2010, 610-628, at 613.

submitted by Member States, *when* these needed to be accepted or rejected vis-a'-vis the exercise of a fundamental freedom.

In rulings pre-dating *Marks & Spencer*, the ECJ frequently rejected justifications based on cohesion of the tax systems, on the territoriality principle and on the risk of tax avoidance. E.g. in cases concerning vertical compensation within corporate groups, such as *ICI*¹⁰ and *Metallgesellschaft*¹¹, the ECJ, in considering the national rules at issue incompatible with the freedom of establishment, refused to accept the cohesion principle when more than one corporate taxpayer is involved¹², and found *no risk* of tax avoidance within *an individual* Member State if one of the group companies (either a subsidiary or a parent company) pays tax *elsewhere* within the EU territory¹³.

A “*global approach*”, taking into consideration the overall situation of the group within the EU, was thus evident. In *Bosal Holding*¹⁴, the ECJ refused a justification, based on the territoriality principle, whereby the costs in connection with activities of subsidiaries in other Member States should be offset against the profits generated by those subsidiaries in such States, rather than against those of parent companies in the concerned Member State. The ECJ stressed that the difference in tax treatment concerned not the subsidiaries but the resident parent companies, according to whether or not they have profit-making subsidiaries in the Member State concerned or in others, and it disregarded the matching between profits taxation and costs deduction at national level. Consequently, at that time, the question could well arise as to whether *Bosal Holding*, together with *ICI* and *Metallgesellschaft*, would imply the definitive application of the territoriality principle at EU level – rather than at national level – at least when invoked against tax avoidance.

Marks & Spencer, which was regarded as marking a turning point in favour of Member States¹⁵, could be seen as providing a negative response to this question, except for “terminal losses”. Notably, the UK had denied a resident parent company the deduction, under the national “group relief” scheme, of losses incurred by subsidiaries in other Member States, which subsidiaries had ceased trading or had been sold. The ECJ, despite considering the refusal of deduction of losses incurred by non-resident subsidiaries to be a restriction to the freedom of establishment¹⁶, accepted *three cumulative justifications* submitted by the UK. In addition to the need to preserve a “balanced allocation of taxing powers” between the different Member States, the two other justifications were the need to prevent a double deduction of the same losses (which might otherwise occur if a non-resident subsidiary’s losses were also deducted in the parent company residence State) and the need to prevent the risk tax avoidance by intra-group tax planning strategies aimed at exploiting losses where they would generate the highest tax savings.¹⁷ The ECJ also noted that this non-deductibility would be disproportionate, and would breach Art. 49 and 54 of the

¹⁰ Case C-264/96, *ICI* [1998] ECR I-4711

¹¹ Joined Cases C-397/98 and C-410/98, *Metallgesellschaft and Hoechst* [2001] ECR I-1727

¹² Case C-264/96, *ICI* [1998] ECR I-4711, para. 29

¹³ *Id.*, para. 26; Joined Cases C-397/98 and C-410/98, *Metallgesellschaft and Hoechst* [2001] ECR I-1727, para. 57

¹⁴ Case C-168/01, *Bosal Holding* [2003] ECR I-09409

¹⁵ M.Lang, *Direct Taxation: Is the ECJ Heading in a New Direction?*, European Taxation, 2006, 421-430

¹⁶ Case C-446/03, *Marks & Spencer*, *cit.*, para. 40

¹⁷ *Id.*, para 43 to 49

TFEU, if losses could no longer be used in the subsidiary residence State¹⁸, i.e. if they were “terminal losses” (for which the risk of double deduction would not exist).

Only in this case, *Marks & Spencer* made the territoriality principle applicable at *EU level*, in the sense that *terminal losses* incurred by subsidiaries must be always deductible *somewhere within the EU*, rather than at *national level*. *Marks & Spencer* in essence adopted the “single country approach” – i.e., an approach protecting the balance between profits taxation and losses deduction for *any individual* tax system - for *annual losses*, and it followed a “global approach” for “*terminal losses*”.

Literature also referred to this last ECJ approach as the “always somewhere approach”¹⁹ and scholars have been disagreeing about its merit. Some consider that the ECJ operated beyond its competence, because the TFEU’s freedoms provide no guidance whatsoever on which State’s jurisdiction takes priority over the other²⁰ for losses deduction; others highlight that this approach aims at ensuring consistency between tax systems at EU level²¹. When losses could no longer be deducted in the jurisdiction where they were incurred, the “always somewhere approach” can actually be justified by the *ability-to-pay* principle (though the ECJ did not mention this in *Marks & Spencer*). A parent company who, after having set up a subsidiary in another Member State, has to liquidate it due to terminal losses, also has to pay the outstanding debts, so that the “terminal losses” can be regarded as an element that reduces its ability-to-pay tax in its residence State. *Outside* the case of “terminal losses”, *Marks & Spencer* may be regarded as symmetrical with ICI from the perspective of the need of preventing tax avoidance. I.e., the establishment of a subsidiary in a Member State other than that of the parent company does not necessarily entail the risk of tax avoidance, because the subsidiary is subject to tax in its residence State (*ICI*), just as the impossibility of deducting subsidiary losses in the parent company residence State does not entail the risk of preventing losses deduction *if* the subsidiary can deduct losses in its own residence State (*Marks & Spencer*).

After *Marks & Spencer*, the ECJ - in dealing with virtually every possibilities relating to cross-border losses as regards the vertical intra-group situations²², the application of national tax consolidation schemes²³, the horizontal intra-group situations²⁴ and the intercompany situations involving head offices

¹⁸ Id., para. 34, 39 to 51 and 55.

¹⁹ E.g., P.Wattel, *Fiscal cohesion, fiscal territoriality and preservation of the (balanced) allocation of taxing powers; what is the difference?*, cit., at 154; B.da Silva, *From Marks & Spencer to X Holding, A (Critical) Overview and Some Open Issues*, in D. Weber & B.da Silva, *From Mark&Spencer to X Holding, The Future of Cross-Border Group Taxation*, Eucotax series, Wolters Kluwer, 2011, at 6; M.Cruz Barreiro Carril, *Los Impuestos Directos y el Derecho de la Unión Europea. La armonización negativa realizada por el TJUE*, Instituto de Estudios Fiscales, 2012, at p. 376

²⁰ P.Wattel, *Fiscal cohesion, fiscal territoriality and preservation of the (balanced) allocation of taxing powers; what is the difference?*, cit., at 154; B. da Silva, *From Marks & Spencer to X Holding, A (Critical) Overview and Some Open Issues*, cit., at p. 6 and 9

²¹ G.Bizioli, *Balancing the fundamental freedoms and Tax Sovereignty: Some Thoughts on Recent ECJ Case Law on Direct Taxation*, 3 *European Taxation*, 2008, 133-140, at p. 137

²² E.g., Case C-347/04, *Rewe Zentralfinanz*, [2007] ECR I-2647, Case C- 231/05, *Oy AA*, [2007] ECR I-6373; Case C-123/11, *A Oy*, ruling issued on 21 February 2013 (not yet reported).

²³ Case C-418/07, *Papillon*, [2008] ECR I-8947, Case C-337/08, *X Holding* 2010 ECR I-1215; Joined Cases C-39/13, 40/13 and 41/13, *SCA Group Holding, X and Others, MSA International Holding*, ruling of 12 June 2014

²⁴ Case C-18/11, *Philips Electronics*, issued on 6 September 2012; Case C-80/12, *Felixstowe Dock and Railway Company*, ruling on 1 April 2014

and branches in different Member States²⁵ - appeared to systematically uphold the “balanced allocation of taxing powers”. As a result, revenue losses for a Member State that would derive from tax planning strategies aimed at choosing the jurisdiction where to deduct losses, are bound to become *undue losses*, and can be prevented by denying cross-border offsetting, *if* these revenue losses are contrary to a given *allocation* of taxing rights²⁶ resulting from national provisions and from provisions of double tax conventions (DTCs) between the Member States involved. Amongst the three justifications that had been cumulatively accepted in *Marks&Spencer*, the balanced allocation of taxing rights became clearly the *prominent* one, since it was accepted not only in conjunction with the need to prevent tax avoidance (e.g., *Oy AA*)²⁷, but even as self-sufficient justification (in *X Holding*)²⁸ against the risk of loss trafficking²⁹ (which is, implicitly, linked again to the need to contrast tax avoidance). On the contrary, the prevention of double deduction became irrelevant when it could not jeopardise the symmetry between deduction of losses and taxation of profits (in which case, however, the balanced allocation of taxing right was also not at risk)³⁰.

Whilst the consistency with the “balanced allocation of taxing powers” appears to have been the driving concern, in the post-*Marks Spencer* area, as regards the deduction of annual cross-border corporate losses, the ECJ has been maintained the “always somewhere approach” as regards (annual) losses suffered by *individual* taxpayers. In fact, in rulings such as *Lakebrink*³¹ and *Renneberg* case³², which expanded the scope of the 1995 *Schumacker* ruling³³, the ECJ had accepted that a work State where a *non-resident employee* earns almost all its income must allow this non-resident taxpayer to deduct rental losses from immovable properties that he suffered in his residence State if there is not a sufficient taxable base there. This because the situation of this taxpayer, a so-called “virtual resident”³⁴, was considered as comparable to that of a resident taxpayer. Although, under the DTC between the work State and the residence State, income from immovable property situated in the residence State would be taxed only in this State, the ECJ accepted that the work State needs to grant *all* tax advantages (including deductions even for immovable properties losses) connected with the non-resident ability-to-

²⁵ Case C-293/06, *Deutsche Schell*, [2008] ECR I-1129; Case C-414/06, *Lidl Belgium*, [2008] ECR I-3601; Case C-157/07, *Krankenheim*, [2008] ECR I-8061; Case C-48/13, *Nordea Bank Danmark*, ruling on 17 July 2014.

²⁶ V.L. Almendral, Tax Avoidance, the “Balanced Allocation of Taxing Powers” and the Arm’s Length Standard: An Odd Threesome in Need for Clarification, in I. Richelle, I. Richelle, W. Schon, E. Traversa (ed), *Allocating Taxing Powers in the European Union*, Springer, 2013, 157

²⁷ Case C-231/05, *Oy AA*, cit., para. 53 to 56 and 58 to 60

²⁸ Case C-337/08, *X Holding*, cit., para. 33

²⁹ Id., para. 28 to 32

³⁰ E.g., Case C-18/11, *Philips Electronics*, cit., para. 23 to 34; Joined Cases C-39/13, 40/13 and 41/13, *SCA Group Holding*, para. 34 to 41, and 53-54

³¹ Case C-182/06 *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705

³² Case C-527/06 *Renneberg* [2008] ECR I-7735

³³ C-279/93, *Schumacker* [1995] ECR I-0225, which started the ECJ case-law stream concerning non-residents earning most or all of their income in the host State.

³⁴ M. Cruz Barreiro Carril, *Los Impuestos Directos y el Derecho de la Unión Europea. La armonización negativa realizada por el TJUE*, Instituto de Estudios Fiscales, 2012

pay³⁵. The ECJ in this case sacrificed the symmetry between taxation of profits and deductions of losses, to allow a cross-border assessment of the taxpayer's overall ability-to-pay³⁶.

Nonetheless, in the situation at issue in the 2013 *K* ruling³⁷, which was a situation of *legal* non-deductibility of losses in the source State, the ECJ ended up neglecting the cross-border ability-to-pay. The ECJ accepted a Finnish provision which did not allow a resident individual to deduct a loss on the sale of immovable property situated in France from the gain made in Finland on the sales of securities. The French immovable property income, due to Finnish provisions and to the DTC between Finland and France, was *neither* taxed *nor* otherwise taken into account for Finnish income tax purposes. The ECJ found that, for this reason, the non-deductibility of loss from the sale of French immovable property ensured the cohesion of the Finnish tax system³⁸, and in essence it expanded the scope of *Bachmann*, in terms of “direct link, ” to the symmetry between an exemption for foreign capital gains and property income, on the one hand, and the refusal to deduct capital losses relating to the same real estate, on the other hand³⁹. Although the ECJ rejected a justification based on the risk of tax avoidance since the Finnish provision were directed to all foreign immovable property losses and not specifically targeted to prevent wholly artificial arrangements⁴⁰, it protected the Finnish tax base from the risk of an erosion, by accepting the cohesion justification. However, as the deduction of French property losses would have broken a balance established by a DTC, the “balanced allocation of taxing powers” could also have been used (whether or not in conjunction with prevention of tax avoidance⁴¹), which increases the overlap between the “cohesion” justification and the “balanced allocation of taxing powers” justification⁴². Moreover, the ECJ found that the refusal to allow the deduction of that loss in Finland was a proportionate measure for ensuring the cohesion of the tax system, because the possibilities to have the losses deducted in the Member State where the property was located (i.e. could not claim that losses are “terminal”) had *never* existed. The ECJ explained that, if the residence State in these circumstances were obliged to allow deduction of foreign immovable property losses, it would bear the adverse consequences arising from the application of the law of the Member State where the property is situated⁴³.

The *K* finding was reiterated by the ECJ in a ruling concerning corporate losses, *Commission v. UK*⁴⁴. Under UK's Corporation Tax Act provisions, a non-resident company must have exhausted all possibility of having the losses taken into account in the accounting period in which the losses were incurred or in previous accounting periods, and there must be no possibility of the losses being taken into account in future accounting periods. The Commission argued that these rules would make it virtually impossible for a resident parent company to obtain cross-border group relief, but the ECJ dismissed the claim: it

³⁵ Case C-182/06 *Lakebrink and Peters-Lakebrink*, cit., para. 34; Case C-527/06 *Renneberg*, cit., para. 63

³⁶ F.Alfredo Garcia Prats, *Revising “Schumacker”*: Source, Residence and Citizenship in the ECJ Case-Law on Direct Taxation: in *Allocating Taxing Powers within the European Union*, I.Richelle, W.Schon, E.Traversa (ed.), 2013,

³⁷ Case C- 322/11, *K*, ruling on 7 November 2013

³⁸ Case C- 322/11, *K*, cit., para. 67-69

³⁹ R.Neydt, S.Peeters, *Balanced Allocation and Coherence: Some Thoughts in Light and Argenta and K*, EC tax review 2, 2014, 64-75, at 75

⁴⁰ Case C- 322/11, *K*, cit., para. 61-62

⁴¹ R.Neydt, S.Peeters, *Balanced Allocation and Coherence: Some Thoughts in Light and Argenta and K*, cit., 75

⁴² D.Weber, *An Analysis of the Past, Current and Future of the Coherence of the Tax System as Justification*, in EC tax review 1, 2015, 43-54, at 48.

⁴³ Case C- 322/11, *K*, cit., para. 78

⁴⁴ Case C-172/13, *Commission v. UK*, ruling on 3 February 2015

found (on the bases of *K*) that, where the *legislation of the Member State of the subsidiary precludes all possibility of losses being carried forward*, the Member State of the parent company may refuse cross-border group relief without thereby infringing freedom of establishment⁴⁵.

This reasoning may be regarded as formally consistent with the *Marks & Spencer* “always somewhere approach” in respect of terminal losses, from the *perspective of a residence Member State’s revenues*. Specifically, in light of the ECJ’s statement that a Member State is not required to adjust its rules to those of another Member State⁴⁶, literature argued that the *Marks & Spencer* case-law should be regarded as referring to losses that can no longer be used for *factual reasons*, such as liquidation of the subsidiary or of a PE, but not to losses that can no longer be used for *legal reasons*, such as the expiry of a limited time period for loss deduction in the subsidiary state or the non-deductibility in this State (as in *K*)⁴⁷. However, if distinguishing between non-deductibility of foreign losses for *factual reasons* and non-deductibility for *legal reasons*, even the *Renneberg* case of non-deductibility in the residence State *in a given tax year for lack of sufficient taxable base* there— where the ECJ held the “virtual residence” (i.e. work) State responsible for granting those deductions - could be regarded as a case of non-deductibility for *legal reasons*, just as the absolute non-deductibility in *K*. Despite the lack of sufficient taxable base for the specific tax year, the law of the residence State could have allowed a carry-forward of (excess) losses to future tax years *if* the legislature of that State had intended to permit losses deductibility. In substance, the ECJ in *Renneberg* had required the deductibility of foreign losses in the “virtual residence State”, at the cost of *neglecting* the balanced allocation of taxing rights⁴⁸ and despite the non-deductibility of these losses in the residence State for *legal reasons*, contrary to the approach subsequently adopted in *K*. Even before *K*, literature, in analyzing other rulings concerning individuals where the ECJ had concentrated only on the situation of the taxpayer within a single country and in contrasting these rulings with the *Schumacker* case-law, had stressed that tensions and contradictions emerged in the overall ECJ case-law⁴⁹.

Therefore, *K* and *Commission v. UK* may be regarded as inconsistent with *Marks & Spencer* and with the *Schumacker* case-law (especially with *Renneberg*) from the *perspective of taxpayers*, i.e. of their interest to have losses always taken into account *somewhere* (and thus to have their ability-to-pay properly assessed), because these two rulings limit the “always somewhere approach” *only* to situations *where* the law of the subsidiary State allows losses deduction. If this is not the case, the “always somewhere approach” appears to be completely replaced by the “single country approach” that, in terms of cross-border losses deduction, becomes a “nowhere approach”. Moreover, this ECJ’s position may risk providing a general incentive for Member States to reduce or even eliminate the possibilities of losses deduction, which outcome would fully contrast with the political conception whereby “Cross border loss relief is a basic need for businesses that expand beyond national borders”⁵⁰.

⁴⁵ Id., para. 33

⁴⁶ Case C-322/11, *K*, cit., , para. 80

⁴⁷ D.Pezzella, *Final Losses under EU Tax Law: Proposal for a Better Approach*, 54 *European Taxation* 2-3, 2014, 71-79, at 77-78.

⁴⁸ E.C.C.M.Kemmeren, *Renneberg Endangers the Double Tax Convention System or Can a Second Round Bring Recovery?* *EC tax review* 1, 2009, 4-15.

⁴⁹ M.Lang, *Recent Case-Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions*, *EC Tax Review* 3, 2009, 98-113

⁵⁰ *Infra*, para. 6 (Conclusions).

3. Balanced allocation of taxing rights vs. ability-to-pay: two alternatives or two complementary concerns?

It follows from the foregoing that, throughout the case-law, concerning *corporate losses* and *cross-border losses suffered* by individual taxpayers, the ECJ would seem to have switched from the initial acceptance of the territoriality principle at EU level (“always somewhere approach”) to a prevailing concern to ensure, *for any* national tax system, the symmetry between taxation of profits and deduction of losses, which is consistent with a “single country approach” and is particularly evident in *K*.

The issue thus arises whether it is possible to discern, in the ECJ case-law, different prevailing concerns for different categories of taxpayers, or, simply, a different application of the same underlying concern in different situations. The first pattern (different ultimate concern for different categories of taxpayers) can be excluded, on the one hand because *Renneberg* and *K* both concerned individuals, on the other hand since, in *Commission v. UK*, concerning corporate taxpayers, the ECJ relied on its findings in *K*.

The alternative explanation – i.e., the possibility of reading the ECJ case-law as meaning that the ECJ has the same underlying concern in all cases, but applies it in different ways to different situations – appears to be more credible. Literature argued that even the possibility of offsetting a subsidiary “terminal” losses – when they are so for *factual* reasons - in the parent company residence State, and thus the “always somewhere approach” for these losses, can be explained as a consequence of the “balanced allocation of taxing rights”: symmetrically to the repatriation of losses upon liquidation of a subsidiary (or of a PE), the parent company residence State would tax final capital gains when arising⁵¹. It can thus be discussed whether the “balanced allocation of taxing rights” and the “single-country approach” are necessarily in contrast with a concern to consider the taxpayer’s (cross-border) ability-to-pay, *or* whether these concerns can be complementary to each other, and be pursued simultaneously. In this last case, the further issue arises as to whether the ECJ, in future case-law, could follow a pattern to reconcile the two concerns and which developments at legislative level could be appropriate.

The cohesion of the tax system, and the “balanced allocation of taxing rights”, can be regarded as serving an *anti-avoidance purpose* and *anti-evasion purpose*, because the deduction of a cost without taxation of a related item of profit would cause an erosion of the taxable base within an individual country. On the other hand, the ability-to-pay principle - due to its very requiring a higher contribution to public expenses on the part of taxpayers in receipt of the higher incomes, i.e. due to its being a parameter for the payment of the “fair share” of tax - is *also* contrary to (tax evasion and) tax avoidance.

In fact, apart from tax evasion, tax avoidance implies the attempt to minimize tax liability, by exploiting gaps and loopholes, irrespective of what would be “fair share”. Moreover, although the application of the ability-to-pay principle varies from one Member State to another, it generally shapes the design of the tax base, the establishing of the tax rate, the choice of the unit of taxation etc.. Cases of cost deduction which are not directly related to items of taxable income *due to a tax-policy choice by the legislator*,

⁵¹ D.Pezzella, *Final Losses under EU Tax Law: Proposal for a Better Approach*, cit., 79

would need to be regarded, by definition, as consistent with the ability-to-pay principle. Nevertheless, any situation of *unintended* lack of symmetry between deductions of costs/losses and taxation of a related item of income, i.e. any case of deduction that, by reason of a taxpayer choice, were not matched by a corresponding taxation, would cause an erosion of the tax base and thus would also conflict with the application of the ability-to-pay principle within an individual Member State.

Accordingly, *symmetry between deduction of costs and taxation of profits* (i.e., balanced allocation of taxing rights) on the one hand, and *ability-to-pay principle* on the other hand, can be regarded as *complementary to each others* in ensuring that taxpayers pay their “fair share” of tax within *any* individual Member State. Having regard to cross-border transactions within the internal market, the ability-to-pay of the taxpayer is necessarily increased by income (leading to increase in financial resources) earned in all jurisdictions, and reduced by losses (leading to reductions in financial resources) suffered in any jurisdiction. It can thus be argued that only a “global approach” can make it possible for the ECJ to take into account all circumstances affecting the taxpayer’s ability-to-pay, whereas only a “single country approach” can serve to identify taxpayers’ *obligations toward* individual Member States (in terms of tax liability) and *individual countries obligations* toward taxpayers (in terms of tax advantages to be offered).

As a result, it appears possible to overcome the dichotomy between a “single country approach” aimed at ensuring the balanced allocation of taxing rights, and a “global approach” that would consider the situation of the taxpayer at cross-border level and would be consistent with ability-to-pay principle. This because – if aiming at taking into account taxpayer’s overall ability-to-pay in cross-border situations and, at the same time, at safeguarding a symmetry between profits taxation and losses deduction - the “global approach” and the “single country approach” could be regarded as *two subsequent steps* of an allocation, as between two Member States, of taxing rights and of responsibilities for granting loss deductions. It would be impossible to completely allocate income/profits taxing rights and cost/loss deduction responsibilities to *each* individual State - to identify *what* is the taxpayer’s position *within* that jurisdiction as a result of domestic rules and DTCs (“single-country approach”) - without considering *all* kinds of income or profit and *all* losses (and costs) at cross-border level (“global approach”).

From this perspective, it could be noted that, in its rulings, the ECJ at the outset always describes all the elements that characterize the global situation of the taxpayer, and that impliedly affect its ability-to-pay (even if ability-to-pay is not expressly mentioned), i.e. it always adopts a “global approach” as a starting point. The ECJ rulings, such as *K*, tolerating situations of cross-border disadvantage which are not redressed within any individual State, can therefore be regarded as rulings in which the ECJ has *not allocated* the responsibility for costs/losses deduction to any individual jurisdiction, i.e. as cases of “*global approach without-allocation of the responsibility for granting losses deductions*”. On the contrary, the ECJ rulings of the *Marks & Spencer* case-law⁵² or of the *Schumacker* case-law stream⁵³ can be considered as rulings where the ECJ *has allocated* this responsibility to an individual State, i.e. as cases of “*global approach with allocation of responsibility for granting losses deductions*”.

⁵² Retro, 2.

⁵³ Id.

Arguably, if one compares the *Marks & Spencer* case-law and the *Schumacker* case-law with *K*, the ECJ allocated this responsibility to individual States only where it found a discrimination (or an unjustified restriction) in the domestic law of a Member State coupled with a comparability between situations of residents and of non-residents within this Member State or between domestic situations and cross-border situations. It has not allocated deduction responsibilities where, as in *K*, it has found non-comparable situations even though cross-border situations were at disadvantage. Such different treatments indicate that the ECJ has been taking into account the ability-to-pay at cross-border level, in essence, only by following a “*global approach with allocation of responsibility for granting losses deductions*”. From the specific perspective of the ultimate anti-avoidance and anti-evasion concern which makes ability-to-pay compatible with a balanced allocation of taxing rights, the ECJ therefore seems to have considered the (cross-border) ability-to-pay *only* when national law of a Member State contains a discrimination or an unjustified restriction hindering the exercise of a fundamental freedom.

These different treatments have all arisen, however, when the affected taxpayers, to challenge national provisions totally or partially denying (costs and) losses deductions, have invoked *only* the TFEU’s fundamental freedoms. Part of the literature, which considered it difficult to reconcile the different approaches used by the ECJ, argued that the *Marks & Spencer* case-law has failed, and that the ECJ should either allow the possibility of always deducting foreign losses with a recapture in the event of profit or return to its case-law prior to 2005, and, in so doing, to allow for the double deduction of losses in two Member States⁵⁴. This argument has been convincingly submitted, essentially, on the ground that, on the one hand, there would be no single definition of loss within the EU⁵⁵ given the different national computation rules, and that, on the other hand, the double deduction of losses would put pressure on Member States to act and to agree in the Council for the introduction of uniform rules on the assessment bases and thus on the determination of losses⁵⁶.

Nevertheless, until a secondary legislation applicable to all cross-border losses and introducing a uniform base for assessment will be introduced (if so), there would appear to be no reason why the ECJ – for the purpose of minimizing tax distortions in the functioning of the internal market - should not use even legal bases *different* from the fundamental freedoms provisions (either as autonomous legal bases or in conjunction with fundamental freedoms). In this respect, the issue arises as to whether taxpayers challenging national tax provisions before the ECJ could find, in the Treaties, in addition to fundamental freedoms, new legal bases not yet invoked to date, that could be used by the ECJ to build an *EU law principle of ability-to-pay* to be applied to all cross-border situations.

4. The potential for a European principle of ability-to-pay: a teleological reading of the Treaty and the EU equality principle as a legal base

Literature already proposed that the ability-to-pay principle should be incorporated by the ECJ in the *acquis communautaire*⁵⁷, and that the ECJ should be able to establish legal thresholds that *national* legislators should respect under the EU loyalty principle⁵⁸. The “always somewhere approach” applied

⁵⁴ M.Lang, *Has the Case-Law of the ECJ on Final Losses Reached the End of the Line*, European Taxation, 12, 2014, 530, at 540.

⁵⁵ Id., 535.

⁵⁶ Id., 540

⁵⁷ F.Alfredo Garcia Prats, *Revisiting Schumacker: Source, Residence and Citizenship in the ECJ Case-Law on Direct Taxation*, cit., 23

⁵⁸ Id., 24

as regards actual final losses was seen as a requirement that income taxes should not be imposed without underlying actual income, and the *Schumacker* case-law (whereby personal and family circumstances should be taken into account in at least one Member State) was considered as a requirement that income taxes should not be imposed below a minimum subsistence level: both these requirements, directly linked with the ability-to-pay principle, would indicate that the ability-to-pay approach has *already been taken* by the ECJ⁵⁹. By contrast, other literature - by distinguishing between a “subjective ability-to-pay” lying in the consideration of an individual taxpayer’s personal circumstances, and an “objective ability-to-pay” consisting of the determination of taxable income - argued that the protection of “subjective ability-to-pay” is one of the ECJ’s primary concerns, but also found that “negative integration” via ECJ case-law is not the most appropriate tool to achieve consistent and equal results⁶⁰. This would occur, primarily, because a number of cases involving inconsistencies with the ability-to-pay principle are caused not by violations of the Treaty by an individual Member State, but by the coexistence of differently structured national tax systems, which cases may not be solved through the action of the ECJ⁶¹.

Nonetheless, what the divergent positions in essence recognize, and what can be seen as undeniable in light of the ECJ case-law⁶², is that, when fundamental freedoms are involved, the ECJ, in substance, *can* request Member States to extend, to an EU-wide scale, their *national rules* shaped on the ability-to-pay principle, and the deduction of losses is undoubtedly a way to take into account the ability to pay taxes (which is reduced by losses incurred)⁶³. Previously, literature seems to have disagreed as to whether or not the ability-to-pay principle could be a valid principle to establish an allocation of taxing rights at an international level and as to whether it provided an answer to the issue of how tax jurisdiction should be shared between Member States⁶⁴, but the arguments put forward did not appear to refer to ability-to-pay as a potential *EU law principle*.

Therefore, if one accepts that harmonization at EU level should take place as regards the assessment bases (and thus the determination of losses), even *these newly harmonized* rules would need (to a greater extent than the current ECJ case-law) to take into account on the ability-to-pay. More specifically, they would need to result in a *European application of the ability-to-pay principle*, i.e. in a *new EU ability-to-pay principle* applying to all cross-border situations (and not simply in an EU-wide extension of national ability-to-pay principles). It would then be essential to indicate which *objectives* should the new EU ability-to-pay principle pursue, and *in what way it should be applied* as regard cross-border losses.

Firstly, the objectives of avoiding both double taxation and double non-taxation, stated by the Commission in its soft-law pieces⁶⁵, would obviously be consistent with the anti-evasion and anti-avoidance concern (a concern which, as highlighted above, makes ability-to-pay compatible with a

⁵⁹ Id., 24-25.

⁶⁰ C.Bardini, *The Ability to Pay in the European Market: An Impossible Sudoku for the ECJ*, in 38 Intertax 1, 2010, 2-20, at 18-19.

⁶¹ Id., at 19.

⁶² Retro, 2.

⁶³ V.R.Almendral, *An Ever-Distant Union: The Cross-Border Loss Relief Conundrum in EU Law*, 38 Intertax 10, 2010, 476-501, at 496

⁶⁴ For a negative reply to this question: A.Easson, *Fiscal degradation and the inter-nation allocation of tax jurisdiction*, EC tax review 3, (1996) 112-113; for a positive answer, although with reference to legal equity principles that would justify the allocation of tax jurisdiction at international level, K.Vogel, *Worldwide vs. source taxation of income-A review and re-evaluation of arguments*, 16 Intertax 8-9, 1988, 216-229; N.H.Kaufman, *Fairness and the Taxation of International Income*, 29 Law and Policy in International Business 2, 1998, 145-203, at 189 ss.

⁶⁵ COM(2011)712final, double taxation in the single market; COM(2012)8806final, Recommendation against aggressive tax planning

balanced allocation of taxing rights): in fact, this concern, whilst certainly implying that double non-taxation is not acceptable, does not mean that double taxation should be tolerated.

In light of these objectives, one could assume that an EU law principle of ability-to-pay *should contribute to minimize* tax-induced distortions in the internal market, and that this would occur if, in all cross-border situations: *a)* taxpayers who have the *same overall amount of income*, whether from domestic sources or from sources in other Member States, are treated equally with regard to the access to all tax deductions relating to their overall ability-to-pay; *b)* all losses and costs would be deducted at least once and all items of profits would be taxed at least once, so as to avoid both situations of double taxation and situations of double non-taxation. The desirable new harmonized rules would thus need to be shaped on a European principle of “subjective” and “objective” ability-to-pay, applying to all taxpayers with cross-border incomes and profits, and allowing a uniform determination of cross-border losses to be deducted (as well as of deductions for individuals’ personal and family circumstances).

Before the introduction of such rules, in a situation where national rules on the determination of the taxable base, and thus on the determination of losses, are still widely different from one State to another, it would be necessary to identify the applicable national rules (residence State rules or source State rules) for determining the amount of losses⁶⁶. However, where a given loss in the source State objectively causes a reduction in the amount of financial resources available to the taxpayer (and, although for different amounts, would be a loss, or would not be a profit, under the rule of the home State too), the negative economic outcome undoubtedly reduces the overall income accruing to the taxpayer (and its ability-to-pay taxes) due to a *wrong investment* in the source State.

In this situation, the *preliminary step* toward the construction of an *EU law principle of (cross-border) ability-to-pay* would arguably need to consider the rules of source (host) State as the relevant ones, for consistency with the very economic integration purpose of the fundamental EU freedoms, which, ultimately, serve to remove barriers to the investment (not in the home State itself but) *in the source State*. This, in turn, would be consistent with the application of the *territoriality principle* at EU level that the ECJ, impliedly, made in the *Marks & Spencer* case-law with regard to terminal losses⁶⁷, and in the *Schumacker* case-law with regard to both personal losses and immovable property losses⁶⁸. As a result of the application of this principle, tax obstacles to the exercise of fundamental freedoms (such as the impossibility to deduct losses) would also be removed.

Throughout its case-law, the ECJ has already been playing a “creative” role when, in interpreting principles laid down in the Treaty, has broadened their scope *beyond* the literal wording of the Treaty: e.g. this was the case when, in its first ruling on the application of fundamental freedoms on direct taxation, i.e. the 1986 *avoir fiscal* ruling⁶⁹, the ECJ interpreted the principle of non-discrimination on grounds of nationality as forbidding even “covert discrimination”, which - without being expressly based on nationality, but on other criteria such as residence - produce the same outcome as discriminations based on nationality. It was also the case when, in the early years, the ECJ case-law developed

⁶⁶ M.Lang, *Has the Case-Law of the ECJ on Final Losses Reached the End of the Line*, cit., 535

⁶⁷ Retro, 2.

⁶⁸ Id.

⁶⁹ Case C-270/83, *Commission v.France*, [1986] ECR 280

fundamental rights in EU law according to an autonomous logic of its own⁷⁰, and, *inter alia*, stated that “respect for fundamental rights forms an integral part of the general principles of law protected by the Court of Justice. The protection of such rights, whilst inspired by the constitutional traditions common to the Member States, must be ensured within the framework of the structure and objectives of the Community”⁷¹. The ECJ could arguably apply this approach to the area of tax law as well, in light of the fact that the ability to pay principle is also common to (the constitutional traditions of) most Member States, and it is either embodied in national Constitutions or set out by the case-law of domestic courts. The statement, in the ECJ’s case-law on fundamental freedoms, that “*Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law*”⁷², would not be an obstacle preventing the ECJ from developing an *EU principle of ability-to-pay*.

By contrast, it would imply that, once such a principle was developed as part of EU law (just as fundamental rights were developed by the ECJ as part of EU law), Member States’ competence in the direct taxation area would need to be exercised consistently with this EU law principle too.

Moreover, it was observed that Art. 19 of the Treaty on European Union (TEU), according to which “The Court shall ensure that in the interpretation and application of the Treaties the law is observed”, means that the ECJ must rule in accordance with the spirit of the Treaty’s freedoms as the only way in which it can ensure that the law is observed and interpreted, and this also implies that the ECJ has the power to *create* legal principles⁷³. According to this reasoning too, the ECJ has to interpret the Treaty in light of the ultimate goal stated in Art. 3(1), i.e. to promote peace, its values and the well-being of its people, which latter should be interpreted broadly and would require allowing cross-border loss relief⁷⁴. As it was stressed, if no cross-border loss relief is provided and the tax does not reflect the real ability to pay, a fictional tax debt is created, which certainly runs against the economic well-being of taxpayers⁷⁵.

Secondly, if one accepts that the ECJ, in its teleological interpretation task, has the power to create legal principles not written in the Treaty, and that it would be able to develop an *EU law principle of (cross-border) ability-to-pay* which would be consistent with the objective stated in Art. 3(1), two other issues arise: which *other* Treaty provisions (*in addition* to fundamental freedoms) could be invoked by taxpayers, and used by the ECJ, to develop such a principle, and *how* this principle could be applied as regards cross-border losses. In view of Articles 2 and 3 of the Treaty on the European Union (TEU), which set out the values and objectives of the EU and refer to concepts such as justice, solidarity and equality, literature argued that these concepts may be interpreted as implying ability-to-pay⁷⁶.

It also noted that there is no express legal bases for the ability-to-pay principle in the Treaty and that this absence, together with the “single country approach”, has resulted in an occasional and inconsistent application of the ability-to-pay principle, which has been taken into account by the ECJ as regards

⁷⁰ D.Chalmers, C.Hadjimannuil, G.Monti, A.Tomkins, *European Union Law*, CUP, 2007, 237

⁷¹ Case C-11/70, *Internationale Handelsgesellschaft* [1970] ECR 1125

⁷² Case C-279/93, *Schumacker*, cit., para.21.

⁷³ R.Monteiro & M.Kiers, *The Court’s Position on Cross-Border Losses: A Quest for the Well-Being of EU Citizens?* EC tax review, 2013-2, 92-99, at 98

⁷⁴ Id., at 99.

⁷⁵ V.R.Almendral, *An Ever-Distant Union: The Cross-Border Loss Relief Conundrum in EU Law*, cit., 495

⁷⁶ F. Vanistendael, *Ability to Pay in European Community Law*, EC Tax Review, cit, 122.

deductions for personal and family circumstances, deductions of business expenses and deductions of losses, although with a distinction between resident businesses (*Marks & Spencer* case-law) and non-business taxpayers (*K*)⁷⁷.

Given that, to date, this occasional application of the ability-to-pay principle has resulted only from the application of fundamental freedoms – which relate to the internal market objective of the EU – it can thus be argued that the potential for the development and the application of the ability-to-pay principle would be much wider if, instead of continuing to rely exclusively on fundamental freedoms granted by the TFEU, taxpayers were also to expressly invoke, before the ECJ, the justice and equality principle set out under Art 2 and 3 of the TEU.

In particular, the *equality principle* is also described, in Art. 20 of the Charter of Fundamental Rights, as meaning that “everyone is equal before the law”. Equality is thus included amongst the EU values in Art. 2 TEU and is referred to in Art. 20 of this Charter, which, by virtue of Art. 6 of the TEU, is given the rank of primary source of EU law. It should be interpreted in accordance with Art. 52(3) of the Charter itself, which refers to the European Convention on Human Rights (ECHR) but *does not prevent* EU law from providing a more *extensive* protection. Accordingly, as equality before the law is stated *without any distinction* between tax law and other areas of law, the ECJ could adopt the widest possible interpretation of this principle, and thus argue that the meanings of the equality as set out in Art. 9 of the TEU (equality of citizens to be observed in all EU activities) and in the Chapter of the Charter of Fundamental Rights, are only illustrative, *but not exhaustive* contents, of the equality principle.

In other words, although the TFEU lacks legal bases expressly referring to the ability-to-pay principle as a general principle of tax law, the ECJ could find in Art. 2 and 6 of the TEU, and in Art. 20 of the Charter on Fundamental Rights, the bases for considering ability-to-pay as inherent in the EU equality principle, which latter would be applicable to tax law too.

Following this line of reasoning, the non-discrimination between residents and “virtual residents”, as set out in the *Schumacker* case-law⁷⁸, and the comparability parameter set out there, is only one of the possible contents of the non-discrimination principle of cross-border situations vs. domestic situations. The ECJ – if using the equality principle to its widest possible extent in the area of tax law, and thus if interpreting equality as implying ability-to-pay as a general principle of EU (tax) law – would have no obstacle in finding another possible content of the non-discrimination principle: *equal treatment of taxpayers* earning the *same amount* of overall income, whether from domestic or cross-border sources, and *different treatment* of taxpayers earning *different amounts of overall income*. As losses, whether domestic or foreign ones, *reduce* the total amount of income, the ECJ would have the possibility, *on the basis of the equality-ability to pay principle*, to affirm that losses, whatever their origin, should *always* be offset against profits, and thus to decide which Member State should grant losses deductions and to what extent.

5. Hypothesis for the explicit introduction and for the working of a European principle of ability-to-pay as regards cross-border losses

⁷⁷ Id., 122 ss.

⁷⁸ Retro, 3.

The draft directive for a common consolidated corporate tax base (CCCTB)⁷⁹, if turned into legislation, would enable groups having subsidiaries in different Member States (as well as individual companies having branches in other Member States) to determine the taxable base according to uniform rules allowing a cross-border offsetting of profits and losses of different group units located in different Member States (or the cross-border offsetting of profits and losses of head office and branches located in different Member States). The cross-border offsetting between profits and losses would serve to determine the consolidated tax base, that would then be shared between the Member States of location of different group units (parent company and EU subsidiaries), or between the Member States of location of the head office and of branches.

The CCCTB scheme does not expressly mention the ability-to-pay, but - by always allowing the cross-border loss offsetting at the level of the parent company in case of intra-group losses (and at the level of the head office in case of inter-company losses) – it would end up making it possible to consider the overall ability to pay *of a group* of companies, viewed in its *own economic unity* despite being composed of separate legal persons (or of an individual company of a Member State having EU branches). Moreover, because the consolidated tax base – which, in essence, would automatically (due to losses offsetting) take into account the overall cross-border ability-to-pay - would be shared amongst the concerned Member States according to an apportionment formula made up of labor, assets and sales, the scheme would arguably allow a proportional application of the ability-to-pay principle, i.e. a fractional application of this principle by each Member State, based on the weight of the taxable units located in its jurisdiction in the apportionment formula. The apportionment criteria set out in the CCCTB scheme, by allowing even Member States of loss-making group units to tax a share of the net consolidated profits arising due to profit gained by group units located in other Member States, would arguably realize the symmetry between taxation of profits and deduction of losses at the level of the individual tax system not for a specific tax year, but over two or more tax years. In fact, when this group unit returns to profit, this would contribute to the tax base share of other Member States too.

Given that the CCCTB legislation, in essence, would end up introducing a fractional application of the ability-to-pay principle, the “equality” principle would offer, *especially* after the introduction of the CCCTB, an even stronger base for the Commission to issue a *soft-law piece* – a Communication, or a Recommendation - on the proportional application of the ability-to-pay principle also to *all* taxpayers falling outside the scope of the CCCTB.

In turn, a soft-law instrument interpreting the equality principle as implying the existence of an *EU law principle of ability-to-pay*, and suggesting its proportional application by Member States (also to all taxpayers falling outside the scope of the CCCTB), could be used by the ECJ to expressly develop the principle into a part of the *acquis communautaire*, as the ECJ did in the past for principles laid down in other soft-law pieces⁸⁰.

⁷⁹ Commission Proposal COM(2011)121/4, Proposal for a Directive on a Common Consolidated Corporate Tax Base, 16 March 2011

⁸⁰ E.g., Commission Recommendation 94/79/EC of 21 December 1993 on the taxation of certain items of income received by non residents in a Member State other than that in which they are resident, OJ 1994 L 39/22: the principles of this soft-law piece were largely confirmed by the ECJ in the *Schumacker* case-law.

On a first reading, it may be argued that CCCTB-companies on the one hand, individual taxpayers and non-CCCTB companies on the other hand, would not be in the same situation from the viewpoint of the purpose of the CCCTB scheme, and therefore that there would be no infringement of the non-discrimination principle if non-CCCTB taxpayers were unable to benefit from the proportional application of the ability-to-pay principle that would be made by the CCCTB. Nevertheless, in a teleological interpretation of the Treaty according to its objective, it would be possible for the ECJ to argue that, for the purpose of Art. 3(1) – i.e., of the EU’s objective of promoting the well-being of its people (without distinctions) – non-CCCTB taxpayer and CCCTB taxpayer would be in the same situation. In fact, the CCCTB scheme would only be an *instrument* toward that purpose, but not an *ultimate end* in itself, so that taxpayers outside the scope of the CCCTB formula apportionment would need to find another pattern to benefit from a proportional application of the ability-to-pay.

In other words, these taxpayers would obviously be outside the scope of the CCCTB formula apportionment, but still within the well-being objective indicated in Art. 3(1) and within the scope of the equality principle laid down in the Treaties and in the Charter of Fundamental Rights (which principle should be applied without discrimination between CCCTB taxpayers and non-CCCTB taxpayers). Therefore, even a corporate taxpayer outside the CCCTB or an individual taxpayer would need to be able to benefit, *mutatis mutandis*, from the cross-border losses compensation and from the proportional application of the ability-to-pay principle. The argument could be strengthened even in light of Art. 1 of the Protocol to Art. 1 of the ECHR, whereby any natural or legal person is entitled to the peaceful enjoyment of his possession, and of Art. 17(1) of the Charter of Fundamental Rights of the EU (“Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss”). In fact, the application of the ability-to-pay principle – by requiring the deduction of all losses and thus by preventing the creation of tax debts that would be generated by an overestimated income – undoubtedly contributes to make it possible the enjoyment of possession, and this also holds true for those taxpayers that would not fall within the scope of the CCCTB.

With regard to these taxpayers, it could thus be argued that the ECJ would have the possibility of making a “fractional” application of the ability-to-pay principle, but it would need to indicate a criteria *other than* the apportionment formula laid down by the CCCTB scheme. In this respect, the ECJ could turn into “hard law” the criteria set out in a soft law piece recommending the proportional application of the ability-to-pay principle. In so doing it could develop, as “creative solution”⁸¹, an EU law principle of ability-to-pay that would require *all* losses resulting in a *reduction* of financial resources to be deducted only once, and that would share the responsibility for one-time deduction of these losses *between* the home and host State, *wherever* the losses originated, according to the *proportion* of the overall profit taxable in *each* of these States.

Admittedly, the ECJ, in the *De Groot* ruling⁸², rejected a pro-quota granting of deductions for personal and family circumstances by the residence Member State when this deduction is not matched by the concession of the pro-quota deductions in the work State(s) as a result of the national rules of these States

⁸¹ F. Vanistendal, *Ability to pay in European Community Law*, cit. 134

⁸² Case C-385/00 *De Groot* [2002] ECR I-11819

or of a double tax convention (DTC) between each of them and the residence State⁸³. Nevertheless, once the CCCTB Directive were introduced and the equality & EU law principle of ability to pay were invoked by taxpayers falling outside the CCCTB scheme, the ECJ would no longer need a DTC between Member States or unilateral national rules to allow a pro-quota deduction of losses (and a pro-quota granting of deductions for personal and family circumstances). I.e., the ECJ could no longer decide on the bases of the legal framework that, in *De Groot*, led it to refuse the pro-quota granting of personal deductions by the residence State, but should decide on the bases of the new legal framework.

Literature already argued that, only with regard to deductions granted to individuals for personal and family circumstances, the ECJ should create a rule of proportional application of personal and family deductions in home and host State⁸⁴, and that terminal foreign losses should be split between the home and the host State *either* on the bases of an allocation key that could be based on the same apportionment formula chosen for the CCCTB *or* on the bases of the arm's length principle⁸⁵. This last alternative would aim, in the view of its proponent, at splitting losses in a way that promotes a territorial connection between the losses to be deducted and the Member State to which they are economically related, because the amount of losses attributable to each State would correspond to the locations of functions, risks and valuable assets within its territory⁸⁶. These suggestions have in common, with the approach here suggested, the argument that the ECJ should abandon its current approach of allocating losses either entirely to host State or entirely to home State, but they were formulated without conceiving the possibility for the ECJ to elaborate an EU law principle of ability-to-pay.

If one accepts that the ECJ would have no obstacle in elaborating such a principle, and that *all* losses, which reduce the amount of financial resources, cause a reduction of a taxpayer's ability to pay tax in *all* Member States where he derives income, an approach of sharing even annual losses according to the proportion of the overall income/profit taxable in each State, would make it possible a fractional application of the ability-to-pay principle. According to this author, such approach – which should be first recommended by a Commission's soft-law piece - could be applied in four subsequent steps: determination of the normal income or profit *accruing* to the taxpayer in each State according to the rules applicable there; aggregation of this income or profit to calculate the overall taxable base; determination of the fraction of income or profit taxable in each State on this overall taxable base; lastly, deduction of the losses (suffered anywhere within the EU) in each State according to this fraction. With regard to "terminal losses", that could no longer be carried forward in the State where they were incurred, this approach could still work by requiring, in this State, a *carry backward* of a fraction of losses⁸⁷ corresponding to the fraction of the past income or profit gained here on the overall income or profit that the taxpayer gained in the last tax year when he gained profits or income in all countries, and by requiring, in the other States, a proportional deduction or (in case of insufficient income or profit) carry forward.

This approach, in essence, could be defined as a "*formulary apportionment in the allocation of the responsibility for all losses deduction*". It would also make it possible to ensure, within each individual

⁸³ Id., para. 101 and 102

⁸⁴ F.Vanistendal, *Ability to pay in European Community Law*, cit. 134

⁸⁵ J.Monsenego, *Taxation of Foreign Business Income within the European Internal Market*, 2012, IBFD, at 322-37

⁸⁶ Id.

⁸⁷ The carry-backward of losses, which leads to a recalculation of tax paid for tax year(s) prior to the tax year in which the loss is incurred and to a tax refund, is already applied in some Member States (e.g., France, Germany, UK).

State, the symmetry between (proportional) taxation of profits and (proportional) deduction of losses, to a greater extent than already done in the case-law.

Such a solution would clearly ignore – for the purposes of intra-EU losses offsetting – the distinction between “residence” State and “source” State, but would manage to achieve more satisfactory result – than the current distinction between losses incurred in the residence State and in the non-residence State – both in terms of Member States’ interests not to grant losses deduction without a possibility of taxing the related profits, and in terms of taxpayers’ interests to always have losses taken into account. It could be regarded as an amended version of the academic proposal, concerning the treatment of individuals earning income in two or more Member States, for a “fractional taxation of income”⁸⁸. In that proposal⁸⁹, in essence, each State (whilst agreeing to apply its progressive tax rate, as determined by considering the individual's worldwide income, to the “fraction” of the overall net income received by the individual in its own jurisdiction) should also agree to grant *pro-quota* deductions for personal and family circumstances, where deductions would still be calculated according to its own rules. In the approach here suggested, the pro-quota deduction would be extended to *all losses* causing a decrease in financial resources, and these losses –*before* the desirable introduction of new uniform rules at EU level – would be determined according to the rules of the State where losses originate (as this would also be the State of origin of the reduction of taxpayer’s financial resources for paying tax also in all other Member States where he derives profits/incomes sources).

An objection that might be made to this solution is that, if any Member State in which a taxpayer has income sources should grant a proportional deduction for all losses incurred *elsewhere* within the EU, but could only tax income accruing to the taxpayer within its own jurisdiction, the symmetry between profits/incomes taxation and (annual) losses deduction at the level of each State (as regards the matching between profits and losses) would be lost. Nevertheless, the counter-argument would be that, with a “fractional taxation of income” (also known as source taxation with worldwide orientation)⁹⁰ - where each State would use the tax rates to take into account also incomes arising in other States - this symmetry could be restored simply through the application of *higher* tax rates (when the sources that caused the shared losses will cause incomes/profits) to such an extent as to *offset*, in terms of tax revenues, *the revenue reduction* previously caused by the pro-quota deduction of losses. To borrow economic terms, the EU ability-to-pay principle here proposed would aim: at promoting inter-nation equity based on economic allegiance⁹¹ in the distribution of taxing rights within the EU, at ensuring that losses wherever originating within the EU would be deducted *pro-quota* in each country (due to their reducing the ability-to-pay tax in each country), and at allowing each country even the symmetry between *reduction* in tax revenues caused by pro-quota loss deduction and *increase* (again in tax revenues) through the use of tax rates to take into account (pro-quota) foreign profits deriving from the same sources from which the (shared) losses originated. In its ultimate effect, this symmetry would be equivalent to a territorial

⁸⁸ K. Van Raad, *Fractional Taxation of Multi-State Income of EU Resident Individuals- A Proposal*, in K. Andersson, P. Meltz, C. Silfverberg (eds), *Liber Amicorum Svem-Olof Lodin*, 2001, 211-221; M. Mossner, *Source vs. Residence – an EU Perspective*, *Bulletin for International Fiscal Documentation*, 2006, 501-506.

⁸⁹ Which, in substance, was also supported by scholars criticizing the *Schumacker* case-law: e.g., A. Cordewener, *Personal Income Taxation of Non-Residents and the Increasing Impact of the EC Treaty Freedoms*, in D. Weber (ed.), *The Influence of European Law on Direct Taxation*, Kluwer Law International, 2007, 35-73, at 67-68.

⁹⁰ M. Mossner, *Source vs. Residence – an EU Perspective*, cit., at 508

⁹¹ N.H. Kaufmann, *Fairness and the Taxation of International Income*, cit., at 197-198

matching between profits taxation and corresponding losses deductions, which the Member States have been trying to protect⁹².

An alternative approach suggested by literature, consisting of the application of the worldwide taxation principle by both residence State and source State and of the granting of full loss relief in both States for losses incurred in the other one⁹³, would extend at cross-border level the national applications of the ability-to-pay principle. By contrast, the idea here proposed advocates the elaboration – by means of a soft-law piece followed by an ECJ case-law adopting its indications - of European ability-to-pay principle. In the author's view, this may trigger a spontaneous convergence of national rules, which, eventually, could *facilitate* the (desirable) legislative introduction of new uniform EU rules (applicable to taxpayers with income and/or profits sources in two or more Member States).

In fact, apart from the circumstance that the CCCTB would have the *potential* of paving the way to a proportional application of the ability-to-pay principle for all categories of taxpayers, if the ECJ followed the “creative solution” of elaborating an EU law principle of ability-to-pay, and, as a result, of requiring a fractional deduction of losses, it would probably be (politically) easier for the Commission to make a new proposal for a Directive on cross-border loss relief for taxpayers excluded from the CCCTB. Even in case of failure to adopt the CCCTB, the equality principle and a teleological interpretation of the Treaty's well-being objective would arguably have the potential of triggering the development of an European principle of ability to pay, along the lines and through the steps here indicated, but, in this situation, the Commission proposal would need to cover *all* taxpayers earning cross-border incomes/profits.

In any case, unlike the previous Commission proposal, submitted in 1990⁹⁴ (before the ECJ case-law) but later withdrawn⁹⁵, the new proposal, due to its being based on an EU law principle of ability-to-pay, could indicate *uniform rules* on the determination of (business) profits and therefore on the calculation of losses too, and could require a proportional deduction of losses by all States (from which the concerned taxpayer derives income and/ or profit sources), in relation to the fraction of his earnings in each State on the overall income/profit.

6. Conclusions

When the Commission referred the UK to the ECJ over cross-border loss relief for improper implementation of the *Marks & Spencer* ruling, the EU Commissioner for Taxation, Customs, Anti-Fraud and Audit stated that “Cross border loss relief is a basic need for businesses that expand beyond national borders. It is essential for entrepreneurship and for creating a positive business environment within the Single Market...”⁹⁶.

⁹² Retro, 2.

⁹³ B.J.M.Terra, P.J.Wattel, *European Tax Law*, Wolters Kluwer, 2012, at 97-98

⁹⁴ COM(90)595, Proposal for a Council directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States, 24 January 1991

⁹⁵ Proposal withdrawn OJ C 5, 9 Jan. 2004, at 20.

⁹⁶ Press release IP/12/1017 on Case C-172/13, *Commission v. UK*, on cross-border loss relief, ruling issued on 3 February 2015

The case law on cross-border loss relief shows that, to date, the “balanced allocation of taxing rights” and the consideration for the cross-border ability-to-pay in light of the taxpayers’ situation in all Member States involved, would seem to have been difficult to reconcile⁹⁷. Nonetheless, they can arguably be reconciled with each other with a view to an *ultimate concern* to prevent tax evasion and tax avoidance within the EU territory, and it can be noted that the discontinuity in the application of the ability-to-pay principle has emerged when taxpayers have been using only fundamental freedoms to challenge national provisions. It is also submitted that the ECJ - by using the EU equality principle, and in light of this principle, of the goals stated in Art. 3(1), and of a new Commission’s soft-law piece - could develop an *EU law principle of ability to pay*, which could mark a turning point.

In other words: when taking fundamental freedoms as the *starting point*, the ECJ has been making an occasional *extension*, at cross-border level, of the principle(s) of ability-to-pay as *designed by national legislators*, which has been leading to situations where “balanced allocation of taxing rights” and consideration of cross-border ability to pay appeared to be difficult to combine.

Conversely, if the ECJ took this *European principle of ability-to-pay* (by assumption, invoked by taxpayers) as a *starting point* to deal with *all cross-border situations* created by the exercise of fundamental freedoms, the outcome would arguably be different. In fact, this principle (whether used in conjunction with fundamental freedoms provisions or alone), whilst being by its very nature compatible with a concern to avoid tax evasion and tax avoidance within the EU territory, would *always* imply the offsetting of cross-border losses within the EU, consistently with the objective of pursuing the “well-being of its people” under Art. 3(1). In economic terms, this objective would in fact require that no tax should be paid for fictitious tax debts arising despite a non-existing wealth. Accordingly, in all cross-border situations, the ECJ would find no obstacle in making a “fractional” application of the (European) ability-to-pay principle in an allocation of the responsibility for losses deduction to (home and host) Member States, in proportion to the share of the overall income/profit earned in each country. This would manage to achieve the symmetry between losses deduction and profit taxation within any individual Member State too, and would thus help reconciling the revenue interests of Member States with the interests of taxpayers to have all circumstances affecting their overall ability-to-pay at cross-border level fully taken into account within the EU.

⁹⁷ Having regard to cases such as *K* and *Commission v. UK*

